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SIPDIS

DEPT FOR AF/S/JDIFFILY; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR OAISA/BARBER/WALKER/JEWELL
USTR FOR COLEMAN
LONDON FOR GURNEY; PARIS FOR NEARY

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TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER
January 21 2005 ISSUE

¶1. Summary. Each week, AMEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Free Electricity to Poor More Expensive than Planned;
- Jo'burg Needs R800 Million to Invest in Electricity Infrastructure;
- Amnesty Program Increases Declared Offshore Assets to R65 Billion;
- Manufacturing Index Improves in December;
- Exports to U.S. Reflect Rising Commodity Prices Rather than Increase in Manufacturing Products;
- Reserve Bank Expects Further Upgrades in Credit Ratings;
- Retail Sales to Grow 8.5 Percent in 2005; and
- Banks Increase Mortgage Lending by 23 Percent.

End Summary.

FREE ELECTRICITY TO POOR MORE EXPENSIVE THAN PLANNED
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¶2. Government's policy of providing free basic electricity for the poor has been lauded as one of the successes of the fight against poverty, but service delivery and administrative problems will be discussed during a cabinet lekgotla (roundtable), convening in Gauteng for the next three days. These problems could become issues in local government elections this year. Ompi Aphane, Chief Director in the Minerals and Energy Department, reported that only 12 percent of the poor had received the free electricity benefit in the 18 months since its launch, while expenditure on the initiative had increased to about R750 million ($125 million using 6 rands per dollar), more than 2.4 times the amount initially budgeted. He noted that the constitutional autonomy of local government meant that the national government could not force the implementation of its policies on other spheres of government. According to Aphane, municipalities having 1.3 million poor were distributing electricity to 3 million consumers, giving free electricity to 1.7 million consumers or 88 percent of all municipal customers, most of whom who did not qualify. Providing free electricity to the poor started began 18 months ago, with R300 million ($40 million, using R7.56 per dollar, the 2003 annual exchange rate average) allocated to municipalities in the form of a conditional grant from national government for the first financial year, and R500 million ($60 million, using 6 rands per dollar) in FY2004. In the first year, municipalities spent R710 million ($94 million, using the 2003 exchange rate) on the program, making up the difference from other provincial sources of income. Eskom, the power company responsible for rural areas and the bulk of the poor, had spent only R46 million last year. Aphane said the main problem was poor targeting and leakages, with many relative well-off households receiving it, while the majority of the poor did not. Many municipalities also did not have the capacity to implement the program. Disputes between municipalities and Eskom also created problems. Of South Africa's 284 municipalities, 57 had not signed funding and service agreements with Eskom for it to provide free basic electricity. These agreements were necessary because Eskom was not constitutionally mandated to provide electricity in municipal areas. Two municipalities disagreed with the free basic electricity program and refused to implement it. Source: Business Day, January 19.

JO'BURG NEEDS R800 MILLION TO INVEST IN ELECTRICITY INFRASTRUCTURE
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¶3. Throughout the past year, Johannesburg has experienced increasing power blackouts, negatively affecting businesses. Talks between the Department of Minerals and Energy (DME), National Treasury, and the Provincial and Local Government Department, were taking place to invest

R800 million ($133 million) in Johannesburg's outdated electricity infrastructure. Representatives from DME cautioned that there were many competing claims on the national budget and that the project would have to be evaluated alongside other priorities. Power failures in the country's industrial heartland were a source of great concern to government because of their economic effect and threat to investment. A department study found that Johannesburg would need R2 billion over five years, but a minimum R800 million investment would get the electricity network to the right level. If the government wanted to update the electricity infrastructure in all of the large metropolitan areas, it would cost R3-4 billion. Johannesburg's problem was the most serious as its network was very old and supplied major industries. According to Ompi Aphane, Chief Director in the DME, a percentage of the electricity tariff paid by consumers should have been used for maintenance, but municipalities used this money for their other services instead. The municipalities claimed that the money allocated them by national government each year from the national budget was not enough for them to perform their functions. A capital grant is required, as tariff-generated investment income would take too long to accrue. Source: Business Day, January 19.

AMNESTY PROGRAM INCREASES DECLARED OFFSHORE ASSETS TO R65 BILLION
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¶4. Applicants for the foreign exchange and tax amnesty declared R65 billion in offshore assets, according to the Department of Treasury's amnesty unit. This figure far exceeds the initial expected increase in offshore assets of R35-40 billion. Amnesty unit spokesman Jannie Rossouw said the R65 billion was calculated at the exchange rates prevailing on February 28, 2003 (about R8 to the dollar) and an additional R2.2 billion in tax revenue should come from amnesty applicants. About 80 percent of this sum would be come from foreign assets remaining offshore, 10 percent from funds repatriated and 10 percent as a tax levy. In terms of the amnesty law, a 5 percent tax would have to be paid on assets repatriated to South Africa and a 10 percent levy on assets that would continue to be held offshore. Altogether about 42,000 applications were received, 23,000 of which have been processed. Rossouw said the adjudication process had taken longer than expected because of the flood of about 23,000 applications in the last few days before the deadline at the end of February last year. The influx meant a unit initially comprising only nine adjudicators and some support staff had to be increased to more than 70 people, 36 of them adjudicators. Another reason for the delay was that applications received close to the deadline were generally more complex than earlier ones and lacked all the necessary information. The adjudication process is expected to be to be completed by midyear. Those granted amnesty would have six months to pay their taxes. Source: Business Day, January 19.

MANUFACTURING INDEX IMPROVES IN DECEMBER

¶5. According to the latest Investec Purchasing Managers Index, manufacturing showed signs of improving in December, but there are indications that weaker export demand and a continuing strong rand may affect future growth. The index, which measures aspects of manufacturing including orders, output and employment, increased to a seasonally adjusted 53.2 points in December, up from 51.6 in November. The higher index reading last month followed two successive months of decline. The improvement came mainly from a build-up of inventories and an improvement in suppliers' performance. However, measures of new sales orders and business activity fell slightly, reflecting the effect of the strong rand on production. Investec Asset Management head of fixed income Andre Roux said yesterday that the slowdown in export growth (exports account for 16 percent of South Africa's economy) and increased import competition were the main reasons for lower manufacturing sales. Last week, Statistics SA's manufacturing production showed a monthly November decline of 1.2 percent compared to October's monthly decline of 0.7 percent, while the rand strengthened more than 11 percent against the dollar over the two months. Roux expected manufacturing activity to grow about 4 percent in 2005, compared with about 5.5 percent last year. Pieter Laubscher, a senior economist at the University of Stellenbosch's Bureau for Economic Research, said yesterday that a crucial determinant of manufacturing growth this year would be the rand. Source: Business Day, January 18.

EXPORTS TO U.S. REFLECT RISING COMMODITY PRICES RATHER THAN INCREASE IN MANUFACTURING PRODUCTS

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¶6. South African Chamber of Business (SACOB) points out that November's increase of $526.6 million compared to November 2003 in South African exports to the United States was primarily due to increased value of precious metals and iron and steel products exports, as international metal prices rose substantially over the past year. Total exports of $5.34 billion to the U.S. for the first 11 months of 2004 exceeded total exports to the U.S. of $4.88 billion for the whole of 2003. In November, precious metals and stones grew 61.6 percent year on year to $212.5 million and iron and steel products increased 333.5 percent to $90 million. For the year to date, precious metals and stones exports increased 29.2 percent to $2.35 billion, and iron and steel products grew 119 percent to $645 million. Many manufactured exports to the United States show sluggish growth. Vehicle exports fell 14 percent to $40 million year on year in November and declined 23.2 percent to $530.3 million for the year to date. Machinery and mechanical exports showed growth of 8.6 percent to $189.2 million, while clothing declined 47.1 percent to $70.8 million for the year to date. Despite the strength of the rand making imports cheaper, the value of imports from the U.S. dropped 17 percent when compared with November 2003. According to SACOB, South Africa had a trade surplus with the United States of $2.45 billion ending in November. SACOB compiled tariff and trade data from the U.S. Commerce Department, U.S. Treasury and U.S. International Trade Commission. The U.S. has not released year-end trade figures yet. Source: Business Day, January 19.

¶7. Comment. Over the past three years, over 30 percent of South African exports went to Europe, of which the United Kingdom had the largest share at 8.4 percent in both 2001 and 2002 and 8.8 percent in 2003. The importance of the U.S. market for South African exports has increased; its share for 1995, 2001, 2002 and 2003 was 4.7, 7.9, 8.1 and 10.5 percent, respectively, demonstrating the impact of AGOA. U.S. share of South African exports is now greater than the U.K. share. Historically, the United Kingdom was South Africa's major trading partner, although the United Kingdom provided over 60 percent of South African foreign direct investment in 2003 and 38 percent of all foreign investment. End comment.

RESERVE BANK EXPECTS FURTHER UPGRADES IN CREDIT RATINGS
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¶8. South Africa's continued build-up of foreign exchange reserves might help the country achieve further credit rating upgrades, according to Daniel Mminele, the head of the Financial Markets Department of the South African Reserve Bank. On January 12, Moody's, an international credit ratings company, upgraded South African debt to Baa1 from Baa2, citing increased foreign currency reserves as one reason. The upgrade, the first by Moody's since November 2001, puts South Africa on the same level as Thailand and Mexico, and one notch below Malaysia. "Further improvements in foreign exchange reserves levels, together with progress being achieved with regard to some of the other challenges highlighted by Moody's, should certainly support the case for another move, not only by Moody's but by other leading ratings agencies as well," Mminele said. Moody's said South Africa must also tackle poverty, unemployment and the HIV/AIDS epidemic, where the government's response had been "frustratingly inadequate." Standard & Poor's, another credit rating firm, said progress on these issues was required before it increased its own rating, which is one notch below Moody's. Source: Business Report, January 19.

RETAIL SALES TO GROW 8.5 PERCENT IN 2005

¶9. The Bureau for Market Research (BMR) expects retail sales to grow 8.5 percent in 2005 with sales expected to reach R350 billion ($58 billion), benefiting from low interest rates and inflation. Sales of semi-durable goods such as clothes and footwear are predicted to grow 10 percent, while growth in non-durable such as food and beverages, and durable items such as refrigerators and cars, are expected to vary between 7 percent and 8 percent, respectively. According to BMR, it takes 18 to 24 months for interest rate cuts to have an effect on retail sales. The two other factors leading to high growth in the retail sector are the relatively low inflation and the emerging black middle class, which benefit the clothing, footwear, food, motor vehicle and insurance sectors. Recent data released by Statistics SA showed that annual nominal retail sales grew by 16.7 percent (y/y) in October 2004. The figures bring the total for the first 10 months of 2004 to R252 billion, 13.2 percent higher than the R223 billion in the

corresponding period in 2003. Source: Business Report, January 19.

BANKS INCREASE MORTGAGE LENDING BY 23 PERCENT

¶10. South African banks boosted mortgage lending by 23 percent in the year through November as the lowest interest rates in more than two decades made debt cheaper. The total value of mortgage loans granted by South African banks rose to R396.9 billion from R322.4 billion a year earlier, according to data from the South African Reserve Bank. Standard Bank, Africa's largest bank by assets, lent R102.1 billion in home loans during the year, an increase of 40 percent. FirstRand, the owner of the second-largest South African bank, lent R61.1 billion, a gain of 22 percent, while Nedcor's Nedbank, the third-ranked bank, increased home loans by 11 percent. Home loan lending by ABSA Group, the nation's fourth-ranked bank, rose 24 percent to R122.4 billion. Source: Business Report, January 19.

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